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March 14, 2003

EX PARTE

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: Commercial Availability of Navigation Devices (CS Docket No. 97-80)

Dear Ms. Dortch:

This is to notify you that on March 14, 2003, Robert Sachs, NCTA's President & CEO, Daniel Brenner, NCTA's Senior Vice President, Law & Regulatory Policy and I met with Commissioner Kevin J. Martin and Catherine Bohigian, Legal Advisor to the Commissioner, to discuss issues in the above-referenced proceeding. In particular, we discussed NCTA's position on elimination of the Commission's rule prohibiting cable operators from providing set-top boxes with embedded security as of January 1, 2005.

Our discussion reflected positions NCTA has taken in written submissions in this docket, as summarized in the document attached hereto.

Respectfully submitted,

/s/ Neal M. Goldberg

Neal M. Goldberg

NMG:gml

Attachment

cc: Commissioner Kevin J. Martin
Catherine Bohigian, Legal Advisor

THE 2005 BAN ON INTEGRATED SET-TOP BOXES SHOULD BE ELIMINATED

Two major events – the 2002 MSO-CE Manufacturer Agreement on "Plug and Play" DTV Products and the cable industry's 2001 retail initiative for integrated set-top boxes – have fundamentally changed the basis for the 2005 Ban on Integrated Set-Top Boxes. The ban would limit consumer choice and impose a tax on cable customers, who will have to pay more for equipment that may not be best suited to meet their needs. It should be eliminated.

I. THE CABLE INDUSTRY HAS MADE A FIRM COMMITMENT TO FACILITATE NEW RETAIL DISTRIBUTION CHANNELS AND TO SUPPORT POD-ENABLED DEVICES, AS EXEMPLIFIED BY THE 2002 MSO-CE MANUFACTURER AGREEMENT ON "PLUG AND PLAY" DTV PRODUCTS.

- The MSO-CE Agreement and related cable industry actions eliminate any doubt as to cable's commitment to a retail market and to new suppliers of set-top boxes for themselves.

- The MSO-CE Agreement will result in a wide variety of POD-enabled products (e.g., integrated DTVs and other multifunction CE devices) that manufacturers believe are viable at retail because set-top functionality is a small fraction of total receiver cost. This is a market-based means for promoting retail availability, far superior to efforts to reshape cable rate regulations or MSO purchase orders. At the same time, MSOs must make these POD-enabled "plug and play" DTV products work with their systems or face the wrath – and defection – of their own customers.

- Although stand-alone integrated set-top boxes have not to date been sold at retail, the MSO-CE Agreement may change this. Indeed, if the 2005 ban is eliminated, the cooperative inter-industry focus on development of a retail market for cable-ready equipment reflected in the MSO-CE Agreement may, in fact, spur leading CE manufacturers, which are now invested in manufacturing POD-enabled digital TVs and other digital equipment for cable customers under the Agreement, to consider manufacturing cheaper <u>integrated set-top boxes</u> for cable operators and the retail market, thereby further enhancing competition and consumer choice. By contrast, retaining the ban and thereby mandating the provision <u>solely</u> of POD-host combinations in lieu of integrated set-top boxes will only increase the costs to those would-be cost-cutting new entrants (<u>see</u> cost discussion in section III below).

- Because the MSO-CE Agreement <u>requires</u> digital cable systems to support POD-enabled devices, it obviates the need for the costly integration ban which arguably served that purpose.

- In addition to the MSO-CE Agreement, cable operators have strong independent reasons to promote retail availability of equipment. In particular, cable operators' core business is the sale of <u>services</u>, not the sale or lease of set-top boxes or other cable customer <u>equipment</u>. Because cable operators face vigorous competition from DBS and others, they have every incentive to maximize the equipment options for navigation devices, especially at retail.

- If the ban were to remain in place, it would throw a monkey wrench into the continuing MSO-CE discussions regarding standards for two-way products. That's because cable's set-top box suppliers immediately would have to start making POD-enabled hosts and PODs built to current standards for operator deployment in 2005. One huge benefit of the MSO-CE Agreement is that the specifications for "plug and play" products are <u>mutually agreed to</u> by operators and manufacturers. That's not true of the current POD or host standards. It makes no sense to keep the ban in place and force cable suppliers to waste tremendous resources building PODs and host devices based on the <u>existing</u> two-way specifications, when ongoing MSO-CE negotiations may result in <u>changes</u> to these very specifications to better facilitate two-way retail products.

II. THE INDUSTRY'S 2001 COMMITMENT TO ALLOWING RETAIL SALES OF INTEGRATED SET-TOP BOXES HAS CHANGED THE FACTUAL BASIS UNDERLYING THE 2005 RULE.

- The rationale for the ban was based on the assumption that integrated set-top boxes could continue to be available <u>only</u> through the cable operator. The Commission explicitly justified its decision to ban integrated set-top boxes on the basis that "[a]llowing MVPDs the advantage of being the <u>only</u> entity offering bundled boxes [<u>i.e.</u>, integrated boxes with embedded security] could adversely affect the development of this equipment market," and that accordingly "the prohibition on integrated boxes allows for equal competition in the marketplace."

- Given the cable industry's commitment to allow the very same <u>integrated</u> set-top boxes provided by cable operators themselves to be made available to consumers <u>through independent retail outlets</u>, applying the Commission's own reasoning, the prohibition can no longer be justified, particularly given the significant added costs which maintenance of the ban would impose on all cable customers.

- By allowing retailers to sell integrated set-top boxes that are <u>identical</u> to those the operator leases, the cable industry has fully addressed the retailers' concern that operator-leased integrated set-top boxes are superior to digital host devices with separate security.

III. A BAN ON INTEGRATED SET-TOP BOXES WOULD SUBSTANTIALLY INCREASE EQUIPMENT COSTS (AND MONTHLY LEASE PRICES) AND REDUCE EQUIPMENT OPTIONS FOR CONSUMERS.

- As Chairman Powell observed in dissenting to the 2005 prohibition, it "is contrary to good public policy to remove from the market a potentially cost-effective choice for consumers." Yet, this is precisely what the ban does.

- Even in deferring to the FCC's prior decision, the D.C. Circuit suggested that "consumers might have chosen not to purchase retail devices for perfectly sensible economic reasons -- because, for instance, there are efficiency gains captured in the manufacture of an integrated box that lead it to cost less" and that "the integration ban does nothing more than deny the most cost-effective product choice to consumers -- an ironic outcome for an order implementing 'one of the most pro-consumer, pro-competitive provisions of the Telecom Act.'"

- The 2002 House Telecommunications Subcommittee's DTV Transition staff discussion draft makes this same point in proposing elimination of the integration ban. As Chairman Tauzin recognized in his opening statement during the hearing on the discussion draft: "[i]ntegrated boxes may very well be more convenient and less expensive for consumers – at the very least, there is another choice for consumers."

- There is ample record evidence showing the potential cost advantages and other benefits that integrated set-top boxes offer to customers. NCTA has shown that a POD-host combination would cost a cable operator approximately $72 to $93 more than an integrated set-top box performing the same functions. This translates into an average consumer price increase of between approximately $2.00 to $3.00 per month for <u>each</u> leased POD-host combination (assuming both the POD and host are rate regulated), based on a five-year and three-year depreciable life, respectively.

- Even using the cost figures alleged by retailers in their own <u>ex parte</u> filings -- which NCTA continues to believe substantially understate the added costs associated with a POD-host combination -- implementation of the ban on integrated set-top boxes would impose <u>hundreds of millions of dollars in additional equipment costs on consumers</u>. And these costs would be borne by consumers with no corresponding public interest benefit.

- Indeed, the ban would force cable subscribers to bear these added costs even though the enhanced portability of such host devices provides no added value for consumers who prefer to <u>lease</u>, rather than <u>purchase</u>, their set-top boxes, because those boxes stay within one operator's cable system.

- The best public policy is to ensure that consumers can <u>choose</u> the equipment option that best fits their preferences. While some consumers may prefer the particular features in an integrated set-top box, which might be offered by a cable operator or a retailer, others may prefer the different features offered in a POD-host combination. As Chairman Powell has observed, the ban on integrated set-top boxes forces cable operators to make procurement and technology decisions "so as to avoid the potential for stranded investment, not on the basis of what might be best for their customers." By contrast, if the ban is eliminated, cable equipment investments and consumer equipment prices will (as they should) be driven by consumer choice and competition.